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No. 93-404

In the Supreme Court of the United States

OCTOBER TERM, 1993

ARTHUR L. GUSTAFSON, ET AL., PETITIONERS

v.

ALLOYD CO., INC., ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE SUPPORTING RESPONDENTS

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QUESTION PRESENTED

Whether Section 12(2) of the Securities Act of 1933 is applicable to a privately negotiated resale of all the stock of a corporation.

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission (SEC or Commission) is responsible for the administration and enforcement of the federal securities laws. This case involves the scope of Section 12(2) of the Securities Act of 1933, 15 U.S.C. 77*l*(2), the express private right of action for the sale of securities by means of materially false or misleading representations. Private actions under the securities laws serve as a necessary supplement to Commission enforcement actions and provide compensation to injured investors. The Commission therefore has an interest in this case.

STATEMENT

1. In 1989, petitioners, the shareholders of Alloyd Co. (Old Alloyd), a manufacturer of clear plastic blister packaging and heat seal packaging equipment, decided to sell the company. Petitioners retained KPMG Peat Marwick to solicit potential purchasers. In response to the solicitation, respondent Wind Point Partners II (Wind Point) expressed interest in acquiring Old Alloyd. Following negotiations, Wind Point formed a corporation called Alloyd Holdings, Inc., as a vehicle for acquiring the stock of Old Alloyd. J.A. 10-11. Alloyd Holdings, Inc., and petitioners then entered into a stock purchase agreement. J.A. 87-161. On December 20, 1989, the transaction closed, and the name of the new company was changed to respondent Alloyd Co., Inc. J.A. 12.

By February 1990, respondents learned that Old Alloyd's 1989 earnings and year-end book value were significantly less than the estimates used to calculate an adjustment payment at closing. J.A. 12. That discrepancy led to the instant litigation.

2. On February 11, 1991, respondents commenced an action against petitioners alleging a claim under Section 12(2) of the Securities Act of 1933 (Securities Act or Act), 15 U.S.C. 77*l*(2), and a breach of contract claim. J.A. 12, 23-36, 81. The complaint alleged that petitioners materially overstated Old Alloyd's 1989 earnings, both orally and in the stock purchase agreement. As relief, respondents sought to rescind the sale of Old Alloyd's stock. J.A. 32-33.

The district court granted summary judgment in favor of petitioners and dismissed the complaint. J.A. 10-22. Relying on *Ballay* v. *Legg Mason Wood Walker, Inc.*, 925 F.2d 682 (3d Cir.), cert. denied, 112 S. Ct. 79 (1991), the court held that Section 12(2) applies only to initial public distributions of stock, not to aftermarket trading. J.A. 20. The court also concluded that the transaction was not comparable to an initial offering, because the transaction had occurred about 30 years after Old Alloyd had originally issued its stock, and that, "unlike purchasers in most initial offerings, the purchasers in this case had direct access to financial and other company documents, and

had the opportunity to inspect the seller's property."[1] J.A. 21.

3. While respondents' appeal was pending, the court of appeals issued its decision in *Pacific Dunlop Holdings, Inc.* v. *Allen & Co.*, 993 F.2d 578 (7th Cir. 1993), cert. granted, 114 S. Ct. 907, cert. dismissed, 114 S. Ct. 1146 (1994). In that case, the court of appeals rejected the reasoning of *Ballay* and held, based on the language, structure, and legislative history of the Securities Act, that Section 12(2) applies not only to initial public distributions of securities, but also to secondary transactions, including a privately negotiated stock purchase agreement. 993 F.2d at 595. Based on its holding in *Pacific Dunlop*, the court of appeals granted respondents' motion to vacate the district court judgment and to remand the case for further proceedings. J.A. 8-9.[2]

SUMMARY OF ARGUMENT

Section 12(2) of the Securities Act of 1933 provides a private remedy for false or misleading statements used by any person who offers or sells a security "by means of a prospectus or oral communication." The Act specifically defines "prospectus" to include "any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale." In light of the definition of "prospectus," Section 12(2) covers all communications in securities sales, whether public or private, initial or secondary. Nothing in the text of the Act limits Section 12(2) to initial public distributions or exempts private or secondary market sales from that express remedy. Nor does the context of the Act support a departure from the defined term "prospectus" as used in Section 12(2).

The statutory structure strongly reinforces the conclusion that Section 12(2) is applicable to misrepresentations and mis-

[1] Having dismissed the Section 12(2) claim, the court held that it lacked jurisdiction over the breach of contract claim. J.A. 21-22.

[2] On remand, a magistrate recommended, in light of *Pacific Dunlop*, that petitioners' motion for summary judgment on the Section 12(2) claim be denied. J.A. 81-86.

leading statements in all types of securities sales. Congress carved out exemptions for private sales and for ordinary aftermarket trading from the registration requirements of the Act. No similar exemption, however, was applied to Section 12(2). That provision, like the antifraud provision enforced by the government, was made applicable to all types of securities transactions.

Contrary to petitioners' contention, the legislative history affords no basis for restricting Section 12(2) to initial public distributions. The drafting history of the Securities Act indicates, in fact, that Section 12(2) was deliberately freed from exemptions for private and aftermarket transactions that apply elsewhere in the Act. While the committee reports make clear that the principal focus of the Securities Act was on regulation of initial public distributions, that was by no means the only focus of the Act. The reports thus provide no basis for overriding the scope of Section 12(2) suggested by its language and the Act's structure. And Section 12(2)'s application beyond initial public distributions is confirmed by contemporaneous commentators and the consistent view of administrators of the Act.

Finally, policy concerns do not justify limiting Section 12(2) to initial or public transactions. This Court has declined to consult the general purposes of the Act when the meaning of specific provisions can be determined from text, structure, and history. In any event, the claim that Section 12(2) is unnecessary in private transactions is unfounded; to the extent that Congress believed that a relaxed form of regulation of private transactions is appropriate, it provided that relief by exempting private transactions from registration. And, to the extent that policy concerns are raised by applying Section 12(2) to sales in the public securities markets, the remedy for those concerns is legislative or administrative action; the courts cannot fashion exceptions to statutory provisions solely to accommodate perceived policy considerations.

ARGUMENT

SECTION 12(2) OF THE SECURITIES ACT OF 1933 IS APPLICABLE TO THE STOCK PURCHASE AGREEMENT IN THIS CASE

From the enactment of the Securities Act of 1933 until the 1980s, it was well accepted that Section 12(2) applies not only to initial public distributions, but also to aftermarket sales and privately negotiated transactions. That view has long been held by the Commission; it is based in the language of Section 12(2), which covers all types of securities sales made by means of false or misleading written or oral communications; and it accords with the statute's structure and background. In the courts below, petitioners' main contention was that Section 12(2) is limited to initial distributions and does not cover resale transactions.[3] In this Court, petitioners have shifted ground somewhat and now argue that Section 12(2) does not apply to privately negotiated transactions, such as the transaction in this case.[4] In our view, both of those interrelated contentions are incorrect: Section 12(2)'s remedy applies to false or misleading statements in the sale of securities, whether the sale involves an initial distribution to the public, a secondary transaction in the aftermarket, or a privately negotiated sale.[5]

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[3] See Defendants' Memo. In Support Of Mot. For Summary Judgment (filed Oct. 31, 1991, see J.A. 1), at 11-12 ("[T]he sale of Alloyd shares to Holdings was a negotiated resale—a secondary market transaction—not a primary or initial offering of securities. Section 12(2) applies only to material misrepresentations or omissions in the course of a primary or initial offering of securities to the public. *Ballay v. Legg Mason Wood Walker, Inc.* * * *.").

[4] We note that the question presented by the petition encompasses not only the issue of whether Section 12(2) applies to a "privately negotiated" sale of all of a company's stock, but also whether it applies to "resale" transactions. Pet. i. In their merits brief, petitioners have narrowed the question presented to focus on whether Section 12(2) applies to private negotiated transactions. Pet. Br. i. While the courts of appeals have divided on whether Section 12(2) applies to secondary trading in the aftermarket, there is no circuit split on whether Section 12(2) applies to private transactions; the courts have uniformly held that Section 12(2) *does* apply to private transactions. See note 29, *infra*.

[5] The Act does not contain definitions that explicitly distinguish among various types of securities transactions that Section 12(2) covers. It is generally

A. The Language Of Section 12(2) Covers Private Sales And Resale Transactions As Well As Initial Public Distributions

1. Section 12(2) of the Securities Act states that "[a]ny person who * * * offers or sells a security * * * by means of a prospectus or oral communication" containing a material misrepresentation or omission is liable to the purchaser for rescission of the transaction or for damages. 15 U.S.C. 77*l*(2). Section 2(10) of the Act defines "prospectus" to mean "any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale." 15 U.S.C. 77b(10). The text of those provisions establishes a private remedy for misrepresentation that comprehensively covers securities sales.[6]

Nothing in Section 12(2)'s language restricts the provision's application to securities sales in initial or public transactions. The provision applies to all written or oral communications used in offers or sales of securities—with a single express exception. The Act provides that Section 12(2) does not apply to securities that are exempted from the Act by Section 3(a)(2), 15 U.S.C. 77c(a)(2), which, generally speaking, are securities issued or guaranteed by the United States, a State, a municipality, or government instrumentality, and securities issued by national or state banks. Apart from sales involving those exempt securities, Congress did not restrict the remedy provided in Section 12(2) to particular types of securities sales or transactions.

Petitioners seek to limit Section 12(2)'s broad coverage by relying on the term "prospectus," which, in their view, refers only to a document used by an issuer to "solicit investments

understood, however, that an "initial offering" of securities is a sale of securities by the issuer and a "secondary" sale is a subsequent transaction. Initial offerings are, generally speaking, of two types—public and private. An "initial distribution" is understood to be a public offering of securities by the issuer; a "private placement" is an issuer's sale of its securities not involving a public offering. Secondary sales are generally either public resales of stock on organized securities markets or private resales.

[6] The texts of Sections 2(10) and 12(2) of the Securities Act are set out in the appendix to this brief.

from public investors," and which therefore has the effect of limiting Section 12(2) to initial public offerings. Pet. Br. 17; see Securities Industry Association, Inc. (SIA) Amicus Br. 4-9. As defined in the Act, however, the word "prospectus" has a wider significance. Section 2(10) does define the term "prospectus" to include "any prospectus"—and thus to include a document prepared by or on behalf of an issuer to solicit the public to purchase securities. See, *e.g.*, *Black's Law Dictionary* 1451 (3d ed. 1933). Section 2(10), however, also defines a prospectus to include "any * * * notice, circular, advertisement, letter, or communication * * * which offers any security for sale." While one of the functions of that list is to prevent issuers from circumventing the Act by calling a "prospectus" by another name, see SIA Amicus Br. 7, the origins of Section 2(10) indicate that Congress intended the defined term "prospectus" to go beyond documents used in public distributions.[7]

The point of departure for the drafters of the Securities Act was the British Companies Act, 19 & 20 Geo. 5, ch. 23 (1929). See James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 Geo. Wash. L. Rev. 29, 34 (1959) (the drafters of the Act "determined to take as the base of our work the English Companies Act");[8] see also *SEC* v. *Ralston Purina Co.*, 346 U.S. 119, 123 (1953) (characterizing the Companies Act as

[7] Under the regulatory scheme of the Act, a public offering of securities by an affiliate of the issuer through an underwriter is required to be registered under Section 5 of the Act, and the Act requires the use of a formal prospectus, described in Section 10 of the Act, in the offer or sale of those securities. 15 U.S.C. 77e, 77j. Thus, even in its narrowest usage, a formal prospectus is not limited to a document used in offers or sales by the *issuer*, but also includes public sales by affiliates as well.

[8] Shortly after President Roosevelt sent a message to Congress urging the adoption of securities legislation, Representative Sam Rayburn, through the White House, requested assistance in drafting a bill. Landis, who was in 1933 a professor at Harvard Law School and who was later to become Chairman of the Securities and Exchange Commission, was requested by then-professor Felix Frankfurter to prepare a draft bill. Landis, along with Benjamin V. Cohen and Thomas G. Corcoran, took principal responsibility for preparing the initial draft of the House bill; that bill formed "[t]he core of the Securities Act of 1933." James M. Landis, *supra*, 28 Geo. Wash. L. Rev. at 33-34.

a "statutory antecedent[ ]" of federal securities laws); 78 Cong. Rec. 8675-8695 (1934) (reprinting in parallel columns the comparable provisions of the Securities Act and Companies Act). The Companies Act defined "Prospectus" to mean "any prospectus, notice, circular, advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company." 19 & 20 Geo. 5, ch. 23, § 380(1) (1929). The drafters of the Securities Act borrowed the first four terms in the definition of "prospectus" from the Companies Act, but then departed from it significantly. Rather than limiting the term "prospectus" to an "offering to the public," as did the Companies Act, the Securities Act drafters omitted that language and instead added the expansive phrase "any * * * letter, or communication * * * which offers any security for sale." The new formulation suggests that, in deliberate contrast to the Companies Act, the drafters of the Securities Act wanted the term "prospectus" to include more than documents used in public offerings.[9]

In an effort to confine Section 2(10) to documents soliciting the public in an initial offering, petitioners invoke the canon *noscitur a sociis*, "a word is known by the company it keeps." *Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307 (1961). According to petitioners, all of the words in Section 2(10) should be read as applying only to initial public distributions because one of them (*i.e.*, "prospectus") is so limited. Pet. Br. 19-21; see SIA Amicus Br. 7-8. The canon on which petitioners rely is inapplicable here. The listed terms in Section 2(10) include such diverse forms of offering a security for sale as notices, circulars, advertisements, letters, written communications, and radio communications. To give all of those terms the narrow connotation associated with the word "prospectus" stands *noscitur a sociis* on its head: it is to construe every word in a list narrowly because of

[9] In 1954, Congress added two additional terms to the definition of "prospectus": "television" communications and communications that "confirm[ ] the sale of any security." Act of Aug. 10, 1954, ch. 667, § 3, 68 Stat. 683. Those additions confirm Congress's intention to embrace all forms of communication that occur in securities sales.

the meaning of just one of its words. This Court has declined to make such use of the canon of *noscitur a sociis*. See *Russell Motor Car Co.* v. *United States*, 261 U.S. 514, 519 (1923) (rejecting argument that "inasmuch as the application of [one word in a statutory list] must be confined to private contracts, the other words associated with it must be likewise restricted").[10]

While Congress could have used other phrases in Section 12(2) to express an intention to cover all communications that offer a security for sale, see Pet. Br. 21; SIA Amicus Br. 9, the phrase "prospectus or oral communication" was a useful way to underscore that Congress intended to cover not just written communications, but also broadcasts and oral statements. Nor should the phrase "prospectus or oral communication" in Section 12(2) be limited to initial or public transactions on the theory that the phrase would otherwise be superfluous.[11] Pet. Br. 22. The Securities Act is characterized by the use of phrases

[10] *Noscitur a sociis* has its greatest claim to application in response to a party's assertion that one word in a list should be given a meaning that is unrelated to the connotations shared by all of the words on the list. For example, in *Jarecki* the Court considered a statute that gave special tax treatment to any income resulting from "exploration, discovery, or prospecting"; the taxpayer asserted that a new drug constituted a "discovery." 367 U.S. at 307. The Court rejected that reading of "discovery," observing that the words "in conjunction * * * all describe income-producing activity in the oil and gas and mining industries, but it is difficult to conceive of any other industry to which they all apply." *Ibid.* Similarly, in *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, 468 U.S. 207, 218 (1984), the Court construed the phrase "public sale" in light of the accompanying words "issue, flotation, underwriting * * * or distribution," which all have the common feature of relating to underwriting activity. See also *Beecham* v. *United States*, 114 S. Ct. 1669, 1671 (1994). Here, the words in the list – prospectus, notice, circular, advertisement, letter, written communication, and radio communication – do not all share the characteristic of being restricted to initial or public transactions.

[11] Petitioners refer to Section 410(a)(2) of the Uniform Securities Act, 7B U.L.A. 643 (1985), which omits the phrase "by means of a prospectus or oral communication," as an example of how Congress might have drafted Section 12(2) more efficiently if it had desired the Section to reach beyond initial public offerings. Pet. Br. 21. But the principal drafter of the Uniform Act has

intended to denote breadth and emphasis, even if a briefer formulation might have been available. See, *e.g.*, Section 5(a)(1) of the Act, 17 U.S.C. 77e(a)(1) (prohibiting the selling of unregistered securities "through the use or medium of any prospectus or otherwise"). The argument that the statute could have been drafted more concisely does not justify overriding Congress's use of expansive terms; it would be paradoxical to view Section 12(2) as covering only a narrow range of transactions, when Congress used a group of words with a range of meanings in Section 2(10) to define the term "prospectus" inclusively.

2. Section 2 of the Act states that its definitions are applicable "unless the context otherwise requires." 15 U.S.C. 77b. Nothing in the context of Section 12(2) or the balance of the Act requires a departure from the definition of "prospectus" for purposes of Section 12(2). Some sections of the Act do use the word "prospectus" to refer, in context, to the formal selling documents associated with registered offerings of securities. For example, Section 10(a), 15 U.S.C. 77j(a), refers to "a prospectus [that] * * * shall contain the information contained in the registration statement"; Section 10(b), 15 U.S.C. 77j(b), refers to "[a] prospectus * * * filed as part of the registration statement"; and Section 5(b)(1), 15 U.S.C. 77e(b)(1), refers to "any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of Section 10."

The distinction between "prospectus" as broadly defined in the Act to mean every kind of written communication that offers a security for sale, on the one hand, and a formal prospectus meeting the requirements of Section 10, filed by the issuer with its registration statement, on the other, has long been recognized. See, *e.g.*, *Opinion of General Counsel Concerning the Application of the Third Clause of Section 4(1) in Various Situations*, Securities Act of 1933, Rel. No. 2623, 1941 SEC LEXIS 346, at *4-*6 (July 25, 1941), *reprinted at* 11 Fed. Reg.

explained that Section 410(a)(2) has the same meaning as Section 12(2), and that Section 12(2) applies to all types of securities sales. Louis Loss, *Securities Act Section 12(2): A Rebuttal*, 48 Bus. Law. 47, 51-52 (1992).

10,964 (1941) ("[T]he term 'prospectus' as used in the Securities Act covers more than the kind of formal document which the layman ordinarily has in mind when he uses the term."). Congress explicitly recognized that distinction in the definition of "prospectus" in Section 2(31) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(31):

> "Prospectus," as used in [section 22 of the Investment Company Act], means a written prospectus intended to meet the requirements of section 10(a) of the Securities Act of 1933 * * * and currently in use. As used elsewhere, "prospectus" means a prospectus as defined in the Securities Act of 1933.

In contrast to other sections of the Act, Section 12(2) does not contain language restricting "prospectus" to documents filed in connection with registered offerings. In fact, Section 12(2) explicitly covers securities and transactions that are exempt from registration.[12] As to those exempt securities and transactions, "prospectus" in Section 12(2) necessarily includes communications other than those used in initial public offerings registered under the Act, because registration and the use of a formal prospectus are not required for those securities and transactions.

The context of the Act as a whole provides no greater justification for a limitation of Section 12(2) to public or initial sales. While a principal purpose of the Act is to regulate initial public offerings, see Pet. Br. 32-36, this Court recognized in *United States* v. *Naftalin*, 441 U.S. 768, 777-778 (1979), that the Act has other significant purposes as well. In *Naftalin*, the Court rejected the argument that Section 17(a) of the Act, 15 U.S.C.

[12] Section 12(2) applies to "a security (whether or not exempted by the provisions of [Section 3], other than [Section 3(a)(2)])." Section 12(2) thus explicitly applies to all but one of the categories of exempt securities in Section 3, 15 U.S.C. 77(c), including, *inter alia*, short term commercial paper, securities issued by charitable or non-profit enterprises, securities of certain savings and loan associations, securities subject to regulation by the Interstate Commerce Commission, and securities issued by a bankruptcy trustee, as well as to transactions exempted by Section 4. Section 12(2) is inapplicable only to government and bank securities and other securities specifically enumerated in Section 3(a)(2).

77q(a), the antifraud provision enforced by the government, does not apply to aftermarket trades because the Act was " 'preoccupied with' the regulation of initial public offerings of securities, and * * * Congress waited until the Securities Exchange Act of 1934 to regulate abuses in the trading of securities in the 'aftermarket.' " 441 U.S. at 777. While recognizing that the Act is "primarily concerned" with new offerings, *id.* at 777-778, the Court noted that the Act is not limited to that purpose, and that Section 17(a) "was intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading." *Id.* at 778. Section 12(2), like Section 17(a), addresses misstatements in connection with the sale of securities, and *Naftalin*'s observation about Section 17(a) is equally applicable here: the provision "makes no distinction between" initial public distributions and secondary market sales. 441 U.S. at 778.

B. The Structure Of The Securities Act Confirms The Scope Of Section 12(2)'s Coverage

The application of Section 12(2) to private transactions and market trading, as well as to initial public distributions, draws significant support from the structure of the Securities Act. That structure indicates that, when Congress wished to restrict the Act's requirements to initial distributions, it did so through specific exemptions. No such exemptions are applicable to Section 12(2).

1. The heart of the Securities Act is the registration requirement. *Pinter* v. *Dahl*, 486 U.S. 622, 638 (1988). Section 5(a) of the Act prohibits the sale of any security "[u]nless a registration statement is in effect as to [that] security." 15 U.S.C. 77e(a). Section 4, however, expressly exempts from the requirements of Section 5 both "transactions by an issuer not involving any public offering," Section 4(2), 15 U.S.C. 77d(2), and most secondary sales after an initial public offering, Sections 4(1), 4(3), and 4(4), 15 U.S.C. 77d(1), (3), and (4).[13] If Congress had

intended to exclude private or secondary market sales from the reach of Section 12(2), it would have made the Section 4 exemptions applicable, not only to the registration requirement of Section 5, but also to the private cause of action under Section 12(2). As this Court reasoned in *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 692 (1985), in rejecting the argument that a private sale of all of a company's stock was not a transaction in securities, "although § 4(2) of the 1933 Act, 15 U.S.C. § 77d(2), exempts transactions not involving any public offering from the Act's registration provisions, there is no comparable exemption from the antifraud provisions." The "antifraud provisions" involved in *Landreth* were those in the Securities Exchange Act of 1934, not Section 12(2) of the Securities Act of 1933. See 471 U.S. at 684. A companion case to *Landreth Timber*, however, did involve a claim under Section 12(2). *Gould* v. *Ruefenacht*, 471 U.S. 701, 703-704 (1985). *Gould* held, "[f]or the reasons stated in [the Court's] decision" in *Landreth Timber*, that the stock sale in *Gould* involved "securit[ies]" within the meaning of the federal securities laws, notwithstanding the private character of the transaction. *Gould*, 471 U.S. at 704.

The drafters of the Act limited the exemption of the transactions identified in Section 4 to the registration requirements in Section 5 in order to subject those transactions to the private right of action in Section 12(2), as well as to the antifraud provision in Section 17(a), which is enforced by the government. James M. Landis, the Act's principal drafter, see note 8, *supra*, explained that the Section 4 exemptions "are only from Section 5 and not the other provisions of the bill" because:

> Upon section 5 is made to depend practically all the liabilities, whether criminal or civil, that flow from the fact of non-registration or registration. Dealings in securities may, however, be violative of the provisions of the bill, even though they are not related to the fact of registration. (See e.g. Section 12(b) [*sic*; Section 12(2)]; Sect. 16 [Section 17

[13] Section 4(1) exempts "transactions by any person other than an issuer, underwriter, or dealer"; Section 4(3) exempts ordinary trading transactions by a dealer not involving a distribution; and Section 4(4) exempts unsolicited brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market. 15 U.S.C. 77d(1), (3), and (4).

as enacted]; Sect. 18 [incorporating state blue sky laws, deleted before enactment].

James M. Landis, *Reply to Investment Bankers Association Objections of May 5, 1933*, at 5.[14]

2. There is no merit to the view that the structure of the Securities Act shows that Section 12(2) is concerned only with initial public offerings and not private or aftermarket sales, because it is placed after Sections 11 and 12(1), 15 U.S.C. 77k and 77*l*(1), and before Section 13, 15 U.S.C. 77m, and because that cluster of provisions deals only with initial distributions. See *Ballay* v. *Legg Mason Wood Walker, Inc.*, 925 F.2d 682, 691 (3d Cir.), cert. denied, 112 S. Ct. 79 (1991); SIA Amicus Br. 9-10. Section 13 provides the statute of limitations for the private rights of action created in Sections 11 and 12; the issue of whether that provision deals solely with initial public distributions depends on whether Section 12(2) is so limited.

Section 11 (which imposes liability for false or misleading registration statements) was placed adjacent to Section 12 because those provisions contain the Act's only private rights of action. And Section 12(2) was placed in the same section as Section 12(1) (which imposes strict liability for selling securities in violation of the Act's registration requirement) because both create actions against the seller and both share the same remedial provisions (*i.e.*, rescission or, if the security has been sold, damages). The arrangement of those provisions is thus not indicative of any intention to restrict Section 12(2) to initial or public distributions.[15]

[14] Landis collected various intermediate drafts and other materials pertaining to the legislative history of the Act under the title *The Genesis of the 1933 Securities Act* (*Genesis*) (Harvard Law School Library). James M. Landis, *supra*, 28 Geo. Wash. L. Rev. at 29 n.1. Those materials are also collected in volumes in the Commission's library entitled *Legislative History of the Securities Act of 1933, 73d Cong., 1st Sess., 1933*, Vols. I-VI (*SEC Legislative History*). Landis's *Reply* is reproduced in *Genesis*, Item No. 33, and in *SEC Legislative History*, Vol. II, Item No. 3.

[15] Nor does Section 12(2)'s provision of a remedy only for securities purchasers indicate that Congress believed that it was limited to initial public distributions. Pet. Br. 27. The antifraud provision enforced by the government, Section 17 of the Act, is also limited to frauds in the offer or sale of securities, but that provision is clearly applicable to private transactions and aftermarket trading as well as to initial distributions. See *United States* v. *Naftalin*, *supra*.

C. The Textual Reading Of Section 12(2) Is Supported By The Provision's Legislative Background And Subsequent History

Because the scope of Section 12(2) can be gleaned from the language and structure of the Act, only the clearest legislative history could warrant a departure from that meaning. See, *e.g.*, *National Organization for Women, Inc.* v. *Scheidler*, 114 S. Ct. 798, 806 (1994). In fact, the legislative drafting process that produced Section 12(2) lends further support to the conclusion that the provision does not exempt private or aftermarket transactions. Discussions in committee reports do not contradict that conclusion, and, significantly, both contemporary commentators and agency officials considered Section 12(2) to cover the entire range of securities transactions.

1. *Evolution of Section 12(2).* The drafting history of the Securities Act makes clear that Congress intended Section 12(2) to apply to all types of securities sales, not only to public or initial sales. The bill that eventually became the Securities Act (H.R. 5480, 73d Cong., 1st Sess. (1933)) was drafted in the House.[16] In early drafts of the House bill, the remedy for misrepresentations in a prospectus was included in Section 11 (which applied only to registered securities) and was limited to misrepresentations in a prospectus filed with a registration statement; in addition, private and secondary market sales were generally exempted from the provisions of the Act.[17] A subse-

[16] The first House bill (H.R. 4314, 73d Cong., 1st Sess. (1933)) was the Administration bill, which was introduced simultaneously with President Roosevelt's message to Congress recommending securities legislation. (The message is quoted in H.R. Rep. No. 85, 73d Cong., 1st Sess. 1-2 (1933)). That bill, like its Senate counterpart (S. 875, 73d Cong., 1st Sess. (1933)) expressly provided that the remedy for securities purchasers based on misrepresentations was not applicable in private or aftermarket transactions. Neither of those bills, however, formed the basis for the Securities Act or the Section 12(2) remedy that Congress ultimately enacted. See James M. Landis, *supra*, 28 Geo. Wash. L. Rev. at 30-49; H.R. Conf. Rep. No. 152, 73d Cong., 1st Sess. 24 (1933).

[17] Private and aftermarket sales were not exempted from the antifraud provision enforced by the government. See, *e.g.*, Confidential Committee Print

quent draft of the House bill deleted those limitations on the private remedy for misrepresentations in a prospectus. The drafters removed the buyer's remedy for a false or misleading prospectus from Section 11 and placed it in Section 12, where it was not limited to registered securities. And the drafters narrowed the exemptions in Section 4 (including those for private and aftermarket sales) to become exemptions only from Section 5's registration and prospectus-delivery requirements.[18]

Those simultaneous changes had only one purpose: to make the buyer's remedy that is now Section 12(2) applicable to all types of securities sales. The Investment Bankers Association (IBA), the SIA's predecessor, which had participated actively in commenting on drafts of H.R. 5480, immediately publicized that fact, stating that Section 12(2)

> refers to any sale by anyone in interstate commerce of any security by means of any prospectus, notice, circular, advertisement, letter or communication, written or by radio, or any oral communication. There are no exemptions and no exempted transactions. Every individual, including every private investor, comes under this section.

IBA Memorandum of May 5, 1933, at 5 (emphasis omitted) (*Genesis*, Item No. 32; *SEC Legislative History*, Vol. IV, Item No. 10). The IBA, with others, spearheaded a campaign to convince the House-Senate Conference Committee not to adopt the provisions of the pending legislation on this and other points—a campaign that ultimately failed.[19]

2. *Legislative history*. Particularly in light of that drafting record, the legislative history cannot be read to support peti-

No. 1, §§ 4(a) and (b), 11(f), 14(b) (Apr. 19, 1933) (*Genesis*, Item No. 5; *SEC Legislative History*, Vol. III, Item No. 1).

[18] See Confidential Committee Print No. 1, §§ 4, 12 (Apr. 21, 1933) (*Genesis*, Item No. 6; *SEC Legislative History*, Vol. III, Item No. 3).

[19] See *I.B.A. Head Hits Securities Bill*, Wall St. J., May 12, 1933, at 4 (statement of IBA President Frank H. Gordon); Letter of May 6, 1933, to IBA membership, with attached Memorandum (*Genesis*, Item No. 32; *SEC Legislative History*, Vol. IV, Items No. 10 (memorandum) and 13 (letter)); see also 77 Cong. Rec. 3801 (1933) (remarks of Sen. Fletcher, the Senate manager of the bill).

tioners' claim that Section 12(2) has a narrower scope than its language provides. Pet. Br. 35-36; SIA Amicus Br. 14. Petitioners rely on language in a section of the House Report titled "General Analysis," which states:

> The bill affects only new offerings of securities * * *. It does not affect the ordinary redistribution of securities unless such redistribution takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering.

H.R. Rep. No. 85, 73d Cong., 1st Sess. 5 (1933). That statement is an accurate description of the registration provisions of the Act, but it does not capture the bill's full scope. The actual provisions of the bill made the exemptions for secondary trading and private transactions applicable only to the registration requirement—not to the remedy provided in Section 12(2) or to the government antifraud remedy provided in Section 17.[20] See pp. 12-14, *supra*; *United States v. Naftalin*, *supra*. The Committee Report's two-sentence synopsis of the bill is not a substitute for the bill's detailed provisions.

Nor does the House Report's description of the civil liability provisions of the bill provide a sound basis for construing Section 12(2)'s coverage. See Pet. Br. 35 n.13; SIA Amicus Br. 15. The Report states that Sections 11 and 12 apply only to "securities sold upon a registration statement." H.R. Rep. No. 85, *supra*, at 9. That statement is true of Section 11, but the rights of action created under Section 12 also apply expressly to persons who sell securities in transactions that are not registered. The Report further states that liability is restricted to untruths or omissions "in the registration statement or the prospectus." H.R. Rep. No. 85, *supra*, at 9. Section 12(1), however, is not based on misrepresentation at all, and Section 12(2) explicitly applies to misrepresentations in a "prospectus

[20] Indeed, the report specifically noted, in the general description of the bill following the paragraph quoted in the text, that "[t]he Commission may apply to the courts to enjoin any device, scheme, or artifice to defraud, employed in connection with the sale * * * of any securities, *whether new or already outstanding*." H.R. Rep. No. 85, *supra*, at 6 (emphasis added).

or oral communication."[21] The imprecise language in the House Report's overview of the bill thus underscores that the Report does not control the language of the bill as enacted.[22]

The SIA also relies on the fact that the Senate bill, and its accompanying report, S. Rep. No. 47, 73d Cong., 1st Sess. (1933), contained exemptions that limited the civil remedy for purchasers to initial distributions. SIA Amicus Br. 16-18. The short answer to that contention is that the language of the Senate bill did not form the basis for the Securities Act in general or for Section 12(2) in particular. See note 16, *supra.* And there is no significance to the fact that the conference committee's report, H.R. Conf. Rep. No. 152, 73d Cong., 1st Sess. (1933), did not specifically note that the conferees had adopted the broader coverage provided by the Section 12(2) remedy in the House bill. See SIA Amicus Br. 17-18. As this Court has noted, see *Aaron* v. *SEC,* 446 U.S. 680, 699 n.17 (1980), the Conference Report's stated purpose was to identify differences between "the

[21] Similarly, petitioners (Br. 26) and the SIA (Amicus Br. 15) highlight the Report's explanation for eliminating the reliance requirement in Section 12(2). The Report explained that proof of reliance was unnecessary because "[t]he statements for which [the persons liable] are responsible, although they may never actually have been seen by the prospective purchaser, because of their wide dissemination, determine the market price of the security." H.R. Rep. No. 85, *supra,* at 10. The Act, however, does not impose a requirement of "wide dissemination" in order for a purchaser to sue under Section 12(2), and, in any event, the Report's logic is not limited to registration statements. Many representations made in connection with secondary trading also receive wide dissemination and affect the market price of a security. See *Basic Inc.* v. *Levinson,* 485 U.S. 224, 246 (1988).

[22] The SIA notes that several Members of Congress pointed out that the Securities Act would not provide full protection for investors in post-distribution securities trading and that further legislation was needed. SIA Amicus Br. 15-16. Those comments provide no basis for concluding that Section 12(2) does not reach securities sales beyond the distribution context. Congress did enact comprehensive legislation governing the secondary markets in the Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.*, and it is farfetched to infer that because legislators saw the need for that detailed regulatory scheme (which, among other things, created the SEC as a specialized agency to enforce the securities laws), they must have believed that the private right of action in Section 12(2) did not apply to the secondary markets.

House bill and the substitute agreed upon by the conferees." H.R. Conf. Rep. No. 152, *supra,* at 24.

3. *Subsequent interpretations.* Significantly, commentators in the months immediately following the enactment of the Securities Act noted that the Section 12(2) remedy applies to all types of securities sales. William O. Douglas, who was later to serve as a Chairman of the Commission, co-authored an influential and comprehensive review of the Act, which repeatedly recognized that Section 12(2) is not limited to initial or public transactions.[23] Other persons who were deeply involved in the drafting and implementation of the Act also expressed the view, at the time of its enactment and afterwards, that Section 12(2) applies to aftermarket transactions.

One week after the Securities Act was signed into law, the Federal Trade Commission (FTC), which was initially charged with enforcing the Act, issued a release explaining the effective dates of various provisions of the Act. The release states that both Sections 12(2) and 17(a) "apply to outstanding securities as well as to new issues which are to be placed in the market after registration." *Effective Dates of Securities Act of 1933 Are Explained,* Securities Act of 1933, Rel. No. 3, 1933 SEC LEXIS 8, at *2 (June 2, 1933). A few months later, in its release of the rule governing advertising of securities, the FTC reiterated that Section 12(2) applied to securities that were outstanding before the effective date of the Act, even though those securities were not required to be registered:

> The rule applies only to the advertising of securities which are or should be registered under the Act. Those securities which were sold or offered before July 27 of this year may, therefore, continue to be advertised in any form,

[23] William O. Douglas & George E. Bates, *The Federal Securities Act of 1933,* 43 Yale L.J. 171, 183 (1933) (noting that, except for transactions in securities exempt under Section 3(a)(2), no securities or transactions are exempt from Section 12(2)); *id.* at 189-190 (Section 12(2) applies to "every written communication or advertisement offering a security for sale," not only to prospectuses meeting the requirements of Section 10); *id.* at 207-209 (brokers can be liable under Section 12(2) for sales that are not part of an initial distribution).

subject only to the limitations of Sections 12(2) and 17 imposing civil and criminal liability for material misstatements and omissions.

Securities Act of 1933, Rel. No. 54, 1933 SEC LEXIS 59, at *1-*2 (Oct. 13, 1933) (emphasis added).

Similarly, within months of the Act's passage, Arthur Dean, who had consulted closely with the House Commerce Committee during the drafting process, and then-Professor Felix Frankfurter, the organizer of the team that drafted the Act, published articles describing the Act. Dean unequivocally stated that Section 12(2) applies to ordinary market trading as well as to initial public distributions.[24] Likewise, Professor Frankfurter stated that the Act "seeks to terminate the facilities of the mails and of interstate commerce for dishonest or unfair dealings in the sale of all private or foreign government securities, new or old. If any person makes an untrue statement of a material fact or omits to state a fact without which the facts stated would really be misleading, he is subject to a suit for rescission or damages." Felix Frankfurter, *The Federal Securities Act: II*, 8 Fortune 53, 108 (1933). Critics of the Act concurred with that view. Soon after the Act became law, calls went out for its amendment, particularly with respect to its civil liability provisions. Those urging the Act's amendment consistently recognized that Section 12(2) applies to market transactions.[25]

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[24] Dean, who was counsel for the Investment Bankers Association, wrote that Section 12(2) covers "anyone selling any security including outstanding securities, registered securities, or securities exempt from registration * * *, by means of a prospectus or oral communication" that includes a material misrepresentation. Arthur Dean, *The Federal Securities Act: I*, 8 Fortune 50, 102 (1933). After the Act was amended in 1934, Dean wrote another article explaining the revised Act. He reiterated that Section 12(2) imposes liability "on everyone whether Banker Rich or Widow Poor who sells a security by means of a prospectus or oral communication that misstates or omits material facts in the light of the circumstances under which the statements are made." Arthur Dean, *As Amended: The Federal Securities Act*, 10 Fortune 80, 81 (1934).

[25] For example, an American Bar Association committee recommended placing a duty of reasonable care on the plaintiff because Section 12(2) "is not confined to those sellers who have special sources of information but applies

The comprehensive coverage of Section 12(2) sparked later proposals to amend the Act as well. In 1941, in discussing a proposal that enjoyed both industry and SEC support, both the Commission and industry representatives stated that Section 12(2) applies to market transactions.[26] SEC Commissioner Ganson Purcell reaffirmed that view later in 1941 when he informed a House committee of a joint recommendation by the Commission and industry representatives to amend Section 12(2) in order to tailor its requirement of reasonable care to the varied types of transactions it covers. Commissioner Purcell noted that Section 12(2) "is very important in the daily routine of the security business," because it applies "to statements made in the formal prospectus required by the Securities Act"; "to state-

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to all sellers of securities." *Report of the Special Committee on Amendments to the Securities Act of 1933*, 59 Rep. A.B.A. 565, 578 (1934). Similarly, the Committee on Securities Regulation of the Chamber of Commerce of the United States also understood that "any person, even one acting in a private capacity, who *sells* a security—that is not specifically exempted by the Act—either in interstate commerce or by the use of the mails by means of a prospectus or oral communication" containing a materially misleading representation is liable to the purchaser. Congressional Digest, *Should the Federal Securities Act of 1933 be Modified?* 136, 138 (May 1934), quoting *Report of the Committee on Securities Regulation of the Chamber of Commerce of the United States* (Mar. 1934).

[26] See, *e.g.*, Staff of House Comm. on Interstate and Foreign Commerce, 77th Cong., 1st Sess., *Report of the Securities and Exchange Commission on the Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934*, at 14 (Comm. Print 1941) ("Section 12(2) of the act permits a purchaser to recover from a person who has sold securities to him on the basis of untrue statements or misleading omissions. It does not distinguish between sellers engaged in a distribution subject to registration and those selling outstanding securities."); Investment Bankers Association of America *et al.*, *Report on the Conferences with the Securities and Exchange Commission and its Staff on Proposals for Amending the Securities Act of 1933 and the Securities Exchange Act of 1934*, at xi, 149 (1941) (Section 12(2) does not differentiate among "the several situations in which securities are sold"; it applies both to new securities subject to the registration process and "to statements made by brokers seeking to execute customers' orders to sell" where "the security is an outstanding security not subject to those information requirements"; and Section 12(2) perhaps applies as well to "statements made by brokers in the solicitation from their customers of orders to buy").

ments by individual private owners in disposing of their securities"; and "to brokers who sell securities on behalf of their customers."[27]

With few exceptions, commentators have also expressed the view that Section 12(2) is not limited to initial distributions to the public.[28] Courts have also universally applied Section 12(2) to private transactions; and until quite recently, no court had refused to apply the provision to secondary market transactions.[29]

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[27] *Proposed Amendments to the Securities Act of 1933 and to the Securities Exchange Act of 1934: Hearings on H.R. 4344, H.R. 5065, and H.R. 5832 Before the House Comm. on Interstate and Foreign Commerce*, 77th Cong., 1st Sess. Pt. 1, at 806-807 (1941) (Joint Statement of SEC and Industry Representatives, presented by Commissioner Purcell).

[28] Professor Louis Loss early voiced that view, and has consistently adhered to it. See, *e.g.*, Louis Loss, *Securities Regulation* 996-997, 1006-1008 (1951); 3 Louis Loss, *Securities Regulation* 1699, 1712 n.89 (1961); 9 Louis Loss & Joel Seligman, *Securities Regulation*, 4217-4222 (3d ed. 1992). Other treatise writers agree. See 3A Harold Bloomenthal, *Securities and Federal Corporate Law* § 8.05[3], at 8-43 to 8-44.8 (1993); 2 Alan Bromberg & Louis Lowenfels, *Securities Fraud and Commodities Fraud* § 5.2, at 600 (1992); 1 Thomas Hazen, *The Law of Securities Regulation* § 7.5, at 318 (2d ed. 1990); 17A J. William Hicks, *Civil Liabilities: Enforcement and Litigation Under the 1933 Act* § 6.01[3], at 6-12 to 6-39 (1993). Several recent articles reach the same conclusion. See Therese Maynard, *Section 12(2) of the Securities Act of 1933: A Remedy for Fraudulent Postdistribution Trading?*, 20 Sec. Reg. L.J. 152 (1992); Comment, *Applying Section 12(2) of the 1933 Securities Act to the Aftermarket*, 57 U. Chi. L. Rev. 955 (1990); Robert Rapp, *The Proper Role of Securities Act Section 12(2) as an Aftermarket Remedy for Disclosure Violations*, 47 Bus. Law. 711 (1992). Contrary views have been expressed by Elliot Weiss, *The Courts Have It Right: Securities Act Section 12(2) Applies Only to Public Offerings*, 48 Bus. Law. 1 (1992), and Robert Prentice, *Section 12(2): A Remedy for Wrongs in the Secondary Market?*, 55 Alb. L. Rev. 97 (1991). Professor Weiss is apparently the only commentator to suggest that Section 12(2) does not apply to private transactions.

[29] Every court that has considered the issue has ruled that private placements are subject to Section 12(2), even though such placements need not be registered. See *Pacific Dunlop Holdings, Inc.* v. *Allen & Co.*, 993 F.2d 578, 587 (7th Cir. 1993), cert. granted, 114 S. Ct. 907, cert. dismissed, 114 S. Ct. 1146 (1994); *Metromedia Co.* v. *Fugazy*, 983 F.2d 350, 360 (2d Cir. 1992), cert. denied, 113 S. Ct. 2445 (1993); *Haralson* v. *E.F. Hutton Group, Inc.*, 919 F.2d 1014, 1032 (5th Cir. 1990); *Nor-Tex Agencies, Inc.* v. *Jones*, 482 F.2d

These long held views on the scope and coverage of the Act by scholars, securities practitioners, and the agency charged with its enforcement are entitled to considerable weight.

D. Policy Considerations Provide No Basis For A Narrow Application Of Section 12(2)

Although petitioners rely heavily on policy arguments, this Court has declined to permit the general purposes and policies of the federal securities law to override the language of specific provisions. See *Central Bank of Denver* v. *First Interstate Bank of Denver*, 114 S. Ct. 1439, 1453-1454 (1994); *Pinter* v. *Dahl*, 486 U.S. at 654. In any event, rather than suggesting that Section 12(2) should be found altogether inapplicable to private or secondary market securities sales, policy considerations reinforce the longstanding interpretation of the provision.

One of the central purposes of the federal securities laws was to remedy perceived deficiencies in the common law. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 389 (1983). Section 12(2) serves that purpose by providing securities purchasers injured by the seller's misrepresentations or misleading statements

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1093, 1099 (5th Cir. 1973), cert. denied, 415 U.S. 977 (1974); *Woodward* v. *Wright*, 266 F.2d 108, 116 (10th Cir. 1959); *Pawgan* v. *Silverstein*, 265 F. Supp. 898, 900 (S.D.N.Y. 1967). See also *Wright* v. *National Warranty Co.*, 953 F.2d 256, 259-261, 262 (6th Cir. 1992) (Section 12(2) action for misrepresentation in private placement); *Adalman* v. *Baker, Watts & Co.*, 807 F.2d 359 (4th Cir. 1986) (same). Petitioners' claim that there is a conflict in the courts of appeals on whether Section 12(2) applies to private sales is incorrect.

On the other hand, there is a split of authority on whether secondary market transactions are covered. While it appeared unquestioned that Section 12(2) covered secondary market trading when the Court decided *Wilko* v. *Swan*, 346 U.S. 427 (1953) (predispute arbitration clause does not bar a judicial action under Section 12(2) by a customer against a broker), and the view continued to be prevalent as of *Rodriguez de Quijas* v. *Shearson/American Express, Inc.*, 490 U.S. 477 (1989) (overruling *Wilko* and enforcing arbitration clause covering Section 12(2) claim against a broker), the Third and the Eleventh Circuits have recently held that Section 12(2) is inapplicable to secondary trading. *Ballay* v. *Legg Mason Wood Walker, Inc.*, *supra*; *First Union Discount Brokerage Services, Inc.* v. *Milos*, 997 F.2d 835, 842-843 (11th Cir. 1993). The Seventh Circuit reached the contrary conclusion in *Pacific Dunlop*, *supra*.

with a federal cause of action, in which the purchaser need not show reliance and the seller must establish that he did not know and in the exercise of reasonable care could not have known of the misstatement or omission.[30] None of the other express remedies in the Securities Act or the Securities Exchange Act of 1934 provides a private cause of action for misstatements in the sale of securities in private or secondary market sales.[31] Because one of Congress's primary focuses in enacting the federal securities laws was the "need for regulation to prevent fraud and to protect the interest of investors," *United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837, 849 (1975), it is "almost inconceivable" that Congress failed to provide a private remedy for investors based on misstatements in the sale of securities in market transactions.[32] 9 Louis Loss & Joel Seligman, *Securities Regulation* 4220 (3d ed. 1992).

[30] Petitioners err, however, in suggesting (Br. 8, 27-28) that Section 12(2) worked a radical change in the common law obligations a seller owed a buyer or turned every seller into a fiduciary. At common law, rescission was available for innocent material misrepresentations, and an action for deceit was available in some jurisdictions to remedy even negligent misrepresentations. See generally 7 Louis Loss & Joel Seligman, *Securities Regulation* 3421-3424 (3d ed. 1991); 9 *id.* at 4125-4128, 4197-4207. For a contemporaneous review of the common law remedies and Section 12(2)'s relationship to them, see Harry Shulman, *Civil Liability and the Securities Act,* 43 Yale L.J. 227 (1933).

[31] Section 11 of the Securities Act, 15 U.S.C. 77k, applies to misstatements and omissions in a registration statement. Section 9(e) of the Exchange Act, 15 U.S.C. 78i(e), creates a right of action in favor of investors affected by manipulation on a national securities exchange against any person who willfully participates in proscribed acts. Section 18(a) of the Exchange Act, 15 U.S.C. 78r(a), creates a right of action in favor of investors affected by false or misleading statements, made in bad faith, in filings with the Commission.

[32] The implied cause of action under Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5 of the Commission, 17 C.F.R. 240.10b-5, does apply to fraud in private and aftermarket sales of securities. That implied remedy was not recognized until 1946, however, and this Court has "made no pretense that it was Congress' design to provide the remedy afforded." *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson,* 111 S. Ct. 2773, 2779, 2780 (1991); see *Musick, Peeler & Garrett* v. *Employers Insurance of Wausau,* 113 S. Ct. 2085, 2088-2089 (1993). Contrary to petitioners and the SIA's assertions

Petitioners and the SIA raise policy concerns about the application of Section 12(2) to the private transaction at issue in this case.[33] According to petitioners, Section 12(2) protection is unnecessary (and counterproductive) in private transactions because the buyers in such transactions can protect their interests through negotiated terms. Pet. Br. 38-41; SIA Amicus Br. 26-29. In some private placements, however, the transaction is offered through a prepared selling document and there are no negotiations between buyer and seller.[34] Yet there is no evidence that Congress intended some private sales to be subject to Section 12(2) and others not, based on whether the parties engaged in negotiations. Rather, Congress's response to the special nature of private transactions was to exempt private placements from registration; it was not to withdraw a purchaser's right to rescind a transaction tainted by false or misleading statements.

The SIA also raises policy concerns about application of Section 12(2) to ordinary trading in the public securities markets. Amicus Br. 18-26. As noted above, in 1941 the Commission expressed somewhat similar concerns about the appropriate standard of liability to be used in secondary market transactions, and it proposed legislative amendments to Section 12(2) to address that issue. The Commission and the industry agreed at that time that the answer to those policy concerns was not to eliminate Section 12(2) liability for secondary market transactions.

(Pet. Br. 8, 32; SIA Amicus Br. 3 n.3), the existence of the implied cause of action under Section 10(b) therefore sheds no light on Congress's intentions with respect to the scope of Section 12(2).

[33] The dissent in *Landreth Timber* advanced similar policy arguments in opposing the view that the sale of all of a company's stock in a private transaction is a sale of securities. *Landreth Timber Co.* v. *Landreth,* 471 U.S. at 697-700 (dissenting opinion). This Court, however, see *id.* at 694 n.7, declined to rely on those policy considerations to cut back on the coverage of the statutory language.

[34] That has been increasingly the case since the SEC's adoption in April 1990 of Rule 144A, 17 C.F.R. 230.144A, relating to private resales of securities to institutions. See Robert F. Quaintance, Jr., *Getting Comfortable with "Public-Style" Rule 144A Offerings,* Insights, at 8 (Sept. 1993). The protections of Section 12(2) are particularly important in those transactions.

Rather, it was to clarify the proper application of the reasonable care defense. See note 27, *supra,* and accompanying text. The Commission is now exploring possible regulatory action, including clarification of what constitutes reasonable care under the circumstances. The responsibility for remedying any flaws in Section 12(2) lies with Congress and the Commission; the courts may not rewrite the provision to temper effects of its clear language.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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APPENDIX

Section 2(10) of the Securities Act of 1933, 15 U.S.C. 77b(10), provides:

> [U]nless the context otherwise requires—* * * [t]he term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security, except that
>
> (a) a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of [Section 10]) shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of [Section 10] at the time of such communication was sent or given to the person to whom the communication was made, and
>
> (b) a notice, circular, advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus if it states from whom a written prospectus meeting the requirements of [Section 10] may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the Commission, by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors, and subject to such terms and conditions as may be prescribed therein, may permit.

Section 12(2) of the Securities Act of 1933, 15 U.S.C. 77*l*(2), provides:

> Any person who—* * * offers or sells a security (whether or not exempted by the provisions of [Section 3], other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or com-

munication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

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